Volume V, Issue 2
December 2009

political risk insurance newsletter

robert wray PLLC 1150 connecticut avenue, nw | suite 350 | washington, dc 20036

Inside this Issue:

Enforcing Arbitral Awards Against Sovereigns: Process and Pitfalls 1

An Interview with Meg Kinnear, Secretary-General of ICSID 1

Sovereigns Assess the Risks of Investment Arbitration 2

Letter to Our Readers *from Geraldine R.S. Mataka* 8

Enforcing Arbitral Awards Against Sovereigns: Process and Pitfalls

by **Tatyana A. Mikhailova and Felton (Mac) Johnston**

Enforcement of an arbitral award against a sovereign or its state enterprises may seem a routine matter, but it is not always so. When the sovereign resists enforcement, an investor must navigate a complex legal and practical course. This article provides an overview of the process and some of the challenges.

For an investor, winning an arbitration award against a sovereign depends not just on the strength of the investor's case, but also on the choice of forum and on specific terms of the agreement to arbitrate. Investors and their attorneys focus on these matters with a view to creating the best prospects for prevailing. They may also want to consider Denial of Justice coverage from PRI underwriters to protect themselves in the event that a sovereign thwarts the arbitration process itself. But winning an award does not mean getting paid. While most sovereigns, not wanting to jeopardize their reputation for honoring treaty and other obligations, do comply with the awards, there have been some notable recent examples of sovereign resistance to meet award payment obligations promptly, if at all.

Arbitration Award Default (AAD) coverage, which offers compensation when a final and binding award against the sovereign is not honored, could also fill an important gap. *(Readers may wish to see a more detailed discussion of AAD coverage in*

(Continued on page 4)

An Interview with Meg Kinnear, Secretary-General of ICSID

Meg Kinnear *became Secretary-General of the International Centre for the Settlement of Investment Disputes (ICSID) in June of this year, prior to which she served as Senior General Counsel and Director General of Canada's Trade Law Bureau and in other Canadian government positions. We invited Ms. Kinnear, an expert in international investment law and procedure, to respond to some questions about ICSID's role, its legal impact, and its future.*

Q1: The volume of ICSID awards and decisions has grown dramatically in recent years, but the accompanying opinions and interpretations occasionally diverge. Will ICSID awards produce a coherent body of international law? To what extent do ICSID arbitrators regard other ICSID panels' decisions as precedential, or at least to be taken into consideration?

As you know, ICSID tribunals are not bound by the principle of *stare decisis* and there is no formal system of precedent as in a Common Law legal system. That said, the well accepted practice is for tribunals to consider relevant awards and decisions issued by other tribunals and to take these into account when coming to a determination. Perhaps the best statement of this position is by the ICSID tribunal in *Saipem v. Bangladesh*, at paragraph 90 of the award: "The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, it has a duty to seek to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law."

This practice certainly leads to the development of a coherent body of law over time. This evolution can be seen from interpretation of various investment standards of treatment such as expropriation and national treatment, which have been considered extensively in awards over the past 10 to 15 years. Tribunals and parties are clearly aware of the importance of a coherent and clear

(Continued on page 3)

Sovereigns Assess the Risks of Investment Arbitration

by **Mariano Gomezperalta**

We invited **Mariano Gomezperalta**, *General Counsel of Mexico's Ministry of the Economy, to comment on sovereigns' evolving views of international arbitration of investment disputes. In his official capacity, Mr. Gomezperalta has represented the Government of Mexico in several investor-state and state-to-state arbitrations. Prior to his current position he was a member of* robert wray PLLC, *where he participated in privatization projects and international arbitration, as well as numerous U.S. Export-Import Bank guaranteed financings. Mr. Gomezperalta is a graduate of Harvard Law School (LL.M.) and is licensed to practice in Mexico and the State of New York.*

This December will mark the 50th anniversary of what is commonly regarded as the first modern investment protection treaty, the "1959 Treaty" between the Federal Republic of Germany and Pakistan. It set out a series of substantive obligations assumed by each state party, and those obligations are now commonplace in investment treaties. As has been discussed in this Newsletter, in the decades that followed the 1959 Treaty, with particular acceleration since the 1990s, many countries negotiated bilateral investment treaties ("BITs") or, starting with NAFTA, free trade agreements ("FTAs") that contained investment protection chapters.

In comparison with more recent investment treaties, however, the 1959 Treaty differs in one material respect: its dispute settlement mechanism did not confer rights of private action upon nationals of the two states concerned. It provided for binding arbitration of disputes arising under the treaty but only between the two state parties, an approach similar to that taken under the World Trade Organization ("WTO").

Providing the investor/claimant with a right of direct access to international arbitration became more common in later treaties up to the point where it became a fundamental premise in international investment arbitration (giving rise to so-called "investor-state" arbitration). It has been considered that a key feature of a modern BIT is to allow an investor to bring its international claim against the state which allegedly breached the treaty without having to convince its own state to make a claim on its behalf. Moreover, these treaties frequently vary or eliminate the customary international law requirement to exhaust local remedies before an international claim can be brought.

As BITs have burgeoned, so have claims

As might be expected, when a treaty creates a remedy—particularly the power to award monetary damages—parties will invoke this remedy when disputes arise. Therefore, just as we have seen a proliferation of treaties, we are now witnessing a proliferation of investment disputes. For example, for the first thirty years of its existence, the World Bank's International Centre for the Settlement of Investment Disputes ("ICSID") registered only a handful of claims. But after NAFTA entered into force in 1994 and other treaties began to be invoked by investors, ICSID's caseload increased dramatically and it now regularly registers thirty or more investment treaty arbitration claims yearly. There is also an important number of investment claims that are submitted to ICSID and other arbitration centers which arise under investor-sovereign contracts.

Due to the large number of BITs/FTAs and the broadening possibilities of investors gaining legal standing to commence arbitrations against host states, there are now claims being filed that were probably unthinkable a decade ago. For example, a Hong Kong investor was able to successfully bring a claim against Peru. A Malaysian investor in Chile recently succeeded in a claim against Chile under the Malaysia-Chile BIT, as did an investor from Oman in a claim against Yemen. Had these countries not engaged in the trend of signing BITs, none of these claims could have been brought.

Sovereigns attempt to draw some lines

The foregoing, together with the substantial increase in the amounts claimed in arbitration, is currently having an important impact on states' assessment and policy with respect to investment treaties.

To limit their exposure, some states have negotiated more precise treaty text in recent years. The U.S., for example, has opted for much more detailed language to try to ensure that tribunals do not give unduly broad interpretations to the substantive obligations.

When disputes arise, states also commonly argue against overly expansive interpretations of treaty rights, and sometimes this occurs even if such interpretations are against the interests of a state's own investors.

When disputes arise, states also commonly argue against overly expansive interpretations of treaty rights, and sometimes this occurs even if such interpretations are against the interests of a state's own investors. This has happened not infrequently under NAFTA. In a claim against Mexico, *Bayview Irrigation v. Mexico*, the U.S. intervened in support of Mexico's interpretation of NAFTA Article 1101 (the chapter's "scope and coverage" provision which sets out the types of measures to which the chapter relates and hence what sort of claims may be brought). In *Bayview*, the U.S. preferred Mexico's interpretation of Article 1101 over that being advanced by its own nationals. The claimants, seventeen water districts in Texas, alleged that Mexico had breached a bilateral treaty regarding the utilization of waters at the U.S.-Mexico border by allegedly illegally retaining more water than permitted under the bilateral treaty. The water districts alleged violations of NAFTA provisions relating to national treatment and expropriation. The U.S. endorsed Mexico's view that extending substantive NAFTA protections and the right to arbitrate under NAFTA to entities that were not seeking to make or had not made an investment in the territory of the NAFTA party whose measure was at issue would constitute a "radical expansion" of the rights granted under NAFTA. Had the U.S. claimants' theory been accepted, persons who had invested in their own state but

(Continued on page 3)

Sovereigns Assess the Risks of Investment Arbitration (cont'd.)

had not even set foot in the "would-be respondent" state would have been able to challenge some act or omission of that state in international arbitral proceedings.

Some states...are taking the view that investment arbitration creates a monetary exposure that is simply unacceptable from a political and fiscal standpoint....It is more likely that countries will continue to sign BITs but will seek to implement measures that can enhance their capacity to defend arbitration claims.

Likewise, in *GAMI Investments, Inc. v. Mexico*, the U.S. intervened in support of Mexico's view as to what rights and interests a minority shareholder had when it complained of injury suffered by the enterprise in which it had invested. It agreed with Mexico that a minority investor could assert a claim only in respect of harm suffered directly by it (e.g. that a minority non-controlling shareholder could not bring a claim on behalf of an enterprise) nor could it complain derivatively of injury to the enterprise when it did not own or control it). In the U.S.'s view (shared by Mexico), the minority investor could claim only in relation to its own investment (e.g. its shareholding in the Mexican enterprise), and its complaint had to be directed against a measure relating to that investment.

Back to the future?

Some states, however, are taking the view that investment arbitration creates a monetary exposure that is simply unacceptable from a political and fiscal standpoint. Some of these countries (most notably Brazil, which has never embraced investor-state arbitration) apparently have decided to explore alternative ways of protecting foreign investment. (Although Brazil has not followed the regional practice of signing BITs, it has received the largest share of foreign direct investment in South America. This has raised doubts as to whether BITs with private rights of action are as important to attracting investment as many have claimed.)

The approach taken by these countries includes returning to state-to-state dispute settlement mechanisms such as the one provided under the "old" 1959 Treaty. Although such an approach is still far from being a trend, it is interesting to note that even some members of the U.S. State Department's advisory committee on the review of the current Model U.S. BIT have advocated doing away with investor-state mechanisms and using state-to-state dispute settlement structures instead.

It is clear, however, that most countries will not reverse their international agreements or their commitment towards investment treaties. It is more likely that countries will continue to sign BITs but will seek to implement measures that can enhance their capacity to defend arbitration claims. A number of countries, particularly those that have a constant flow of arbitration cases, have established medium-size government offices, often assisted by outside counsel, that take primary responsibility for preventing and defending arbitration claims. Other governments have opted to join resources to create common institutions to face arbitral lawsuits. In this respect, it is worth mentioning that several Latin American countries are currently working, with the support of the Inter-American Development Bank, the United Nations Conference on Trade and Development and the Organization of American States, to create an advisory center for investment disputes which will intend to provide legal assistance to member countries facing arbitration claims. Whether or not that center is finally launched remains to be seen. It is, however, illustrative of the new ways in which governments are trying to mitigate the risks of investment arbitration. ■

An Interview with Meg Kinnear, Secretary-General of ICSID (cont'd.)

jurisprudence which enables claimants and respondents to evaluate the strength of their legal position realistically and also allows states to better assess whether proposed measures might be viewed as contrary to a legal obligation undertaken in a bilateral investment treaty.

Q2: For investors who have relied on ICSID provisions when they invested in Bolivia and Ecuador, what are the legal consequences of the withdrawal of those countries from the ICSID-Convention? What are the practical consequences?

From a legal perspective, two articles in the ICSID Convention address this point directly and should be recalled. Article 71 of the ICSID Convention provides that a denunciation of the ICSID Convention "shall take effect" six months after receipt of a written denunciation notice. Article 72 of the Convention continues to elaborate that a denunciation notice under Article 71 "shall not affect the rights or obligations under the Convention" of that state, of its constituent subdivisions or agencies or of any national of the state arising out of the consent to the jurisdiction of the Centre given by one of them before such notice was received. From a practical perspective, there may be various consequences. However, at the most fundamental level, a denunciation deprives the withdrawing state and its investors of the benefits of the ICSID Convention and investment arbitration pursuant to the Convention.

Q3: Are you concerned that more sovereigns will be tempted to leave (or simply ignore) the ICSID Convention as the volume of claims and awards against them (or the prospect of such claims and awards) increases?

I very much hope that member states will not be tempted to leave ICSID and I welcome new member states that have recently ratified the ICSID Convention or intend to do so in the near future. The role of ICSID is to provide the most efficient, effective and well-informed service to all facility users, and I trust that doing so will discourage states from considering leaving ICSID.

(Continued on page 4)

An Interview with Meg Kinnear, Secretary-General of ICSID (cont'd.)

It is also worth noting that the increase in the volume of claims is not an ICSID-specific phenomenon. Rather, the increase in claims reflects the increase in the number of investment promotion and protection treaties concluded by states in the last two decades. This increase has been experienced equally by other arbitral institutions with investor-state cases. It is also worth noting that while the volume of claims has increased, the assumption that the number of awards adverse to states has increased is a misperception. In fact, empirical studies on investor-state awards suggest that the number of awards against states has not increased and that states win (or lose) in roughly half the cases.

In the vast majority of cases there is no question about the payment of awards and States honour their obligations under the Convention. In a few cases ICSID has reminded States of their obligation to fulfill the terms of a final award, and ultimately this has been resolved.

Q4: To what extent can investors expect the World Bank Group to exert influence over member governments to honor their obligations to the ICSID Convention and ICSID awards?

Signatories to the ICSID Convention undertake to recognize awards rendered as binding and to enforce the obligations imposed by the award as if it were a final judgment of a court in that state. In the vast majority of cases there is no question about the payment of awards and states honour their obligations under the Convention. In a very few cases ICSID has reminded states of their obligation to fulfill the terms of a final award, and ultimately this has been resolved.

Q5: Arbitration was intended (in part) as a definitive mechanism to resolve disputes more expeditiously and less expensively than the courts, but the process appears to grow more protracted and cumbersome over time. What can be done about this?

The time it takes for an arbitration to conclude, and the associated costs of investment arbitration, are a concern for all users of ICSID as well as for the ICSID Secretariat. It is a question that is increasingly discussed, and I believe this dialogue will result in various new mechanisms that can help mitigate the cost and time taken for proceedings. For our part, ICSID has taken various internal steps to ensure that the process is a timely and cost efficient one. For example, the time to register a request for arbitration has been substantially reduced in the past few years, and currently takes an average of 29 days. Similarly, we have made a concerted effort to appoint panels quickly. We routinely suggest that materials be exchanged electronically rather than in numerous hard copies, are developing an electronic case management system that will enhance efficiency of proceedings, and we follow up with tribunals to ensure that awards are rendered within a reasonable time frame. We continue to look for other opportunities to ensure the process is a timely and cost-efficient one. At the same time, we recognize that the issues and facts in many investment cases can be complex and that efficiency and speed should not be at the expense of a fair and thorough process. ■

Enforcing Arbitral Awards Against Sovereigns: Process and Pitfalls (cont'd.)

the October 2005 edition of this Newsletter, which is on our website.) Even so, after compensation under an AAD policy is paid, the policyholder will need to work with its insurer in continuing efforts to recover from the sovereign, in pursuit of its own retained interest in the award and as required by the terms of its AAD coverage.

The enforcement process: the ICSID scenario

"Enforcement" is often casually used to describe the process of obtaining legal *recognition* (or *confirmation*) of the award by turning it into money judgment, and then securing payment by way of seizing assets of the sovereign debtor either at the seat of arbitration or in other jurisdictions (the latter is referred to as *execution)*.

The World Bank's International Center for Settlement of Investment Disputes (ICSID) serves as an arbitration forum for investor-state disputes arising under bilateral investment treaties and free trade agreements. If the investor brings an arbitral claim under the ICSID Convention, the resulting ICSID award is considered to be the equivalent of a final judgment of a contracting state's court (subject only to annulment procedures under the ICSID Convention) and is to be automatically recognized by the contracting states. Execution of an ICSID award, however, is not automatic and is a matter to be decided under the laws of the state where execution is sought. Argentina's determined efforts to resist enforcement of ICSID awards demonstrate how difficult this phase of the enforcement process can be. Another concern regarding ICSID is whether states such as Bolivia and Ecuador, which have withdrawn from the ICSID Convention, will honor treaty obligations that survive their date of withdrawal.

Enforcement of commercial arbitration awards: The New York Convention

Arbitral awards against sovereigns issued by non-ICSID commercial arbitration panels (e.g., under UNCITRAL rules) are *not* automatically recognized as they are subject to judicial confirmation in the jurisdiction where enforcement is sought. The likelihood that such awards will be enforced is greatly enhanced if the country in which

(Continued on page 5)

Enforcing Arbitral Awards Against Sovereigns: Process and Pitfalls (cont'd.)

the arbitration takes place is a member of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") or similar regional conventions such as the Inter-American Convention on International Commercial Arbitration (the "Panama Convention") and the European Convention on International Commercial Arbitration. The New York Convention (of which the U.S. and about 140 other nations are signatories) requires recognition of valid arbitration agreements and resulting awards by the signatory states, subject to certain narrow and expressly articulated exceptions. When the award has been confirmed and transformed into a local court judgment in the country where enforcement is sought, it provides the prevailing party with the right to execute on the judgment.

The New York Convention covers awards rendered in a New York Convention signatory state and its application does not depend on the nationality of the parties. The procedure for recognition and execution of New York Convention awards is governed by national arbitration laws. For example, in the U.S., the New York Convention is codified in the Federal Arbitration Act, which provides for recognition and enforcement of foreign arbitral awards as well as awards made in the U.S. relating to arbitrations between foreign parties (or having some other reasonable relation with a foreign state) and involving legal relationships deemed commercial under U.S. law. The confirmation proceedings are based on a petition to confirm and can be brought within three years of issuance of the award. The U.S. and a number of other countries apply the New York Convention on the basis of reciprocity, recognizing and enforcing only those awards rendered in the territory of another signatory state.

The ability to initiate enforcement proceedings in various jurisdictions under the New York Convention matters greatly because any attachable assets of the sovereign may be in jurisdictions other than the country of the arbitration.

The ability to initiate enforcement proceedings in various jurisdictions under the New York Convention matters greatly because any attachable assets of the sovereign may be in jurisdictions other than the country of the arbitration. While most countries are supportive of international arbitration and provide for expeditious adjudication of enforcement proceedings, award confirmation and subsequent execution efforts against a sovereign, which has a number of avenues to resist enforcement, can prove to be long, tedious and expensive.

Defenses to confirmation of an award under the New York Convention

A party resisting enforcement of a New York Convention award can attempt to vacate the award at the seat of arbitration or in other countries, or otherwise object when the prevailing party seeks to confirm the award. The New York Convention provides several substantive grounds on which recognition may be refused, and the party contesting the award bears the burden of proving that at least one of them applies. These grounds include, among other things, deficiencies in the underlying arbitration process, a violation of domestic public policy or a finding that the laws of the enforcing jurisdiction do not allow the dispute to be settled by arbitration. U.S. courts construe these exceptions narrowly to encourage the recognition and enforcement of arbitral awards.

The New York Convention further provides that recognition and enforcement may be refused or the enforcement proceedings may be adjourned if the award has been set aside or suspended by the courts at the seat of arbitration. These provisions allow, but do not require, the enforcing court to refuse enforcement or suspend the proceedings pending a challenge of the award in the supervisory court. The New York Convention also gives the enforcing party a right to request that the sovereign post security while its challenge is pending elsewhere.

When parallel proceedings arise, investors or insurers should be prepared to deal with protracted litigation in multiple jurisdictions involving various challenges. For example, a sovereign attempting to modify, set aside or vacate an award in a foreign forum can also request injunctive relief to prevent the prevailing party from proceeding with its enforcement actions in other countries. The enforcing courts will need to weigh the rights of the parties and international comity considerations when deciding whether they should give deference to such parallel proceedings.

The effect of annulment measures

A sovereign may ultimately succeed in having the award annulled in its own courts. Can a prevailing party still enforce the award in other jurisdictions? This depends on whether the annulment was made in the country of the seat of arbitration or elsewhere.

The jurisdiction of a court at the seat of arbitration and all other courts to annul an award under the New York Convention was examined by a U.S. federal court in a dispute that arose out of contracts for the construction and operation of an electrical power plant in Indonesia between Indonesian state-owned Pertamina and Karaha Bodas Co. ("KBC"). A tribunal seated in Switzerland awarded KBC over US $260 million. Pertamina applied to the Swiss court for an annulment of the award but failed, so it secured an annulment in an Indonesian court. Relying on the Indonesian court's annulment, Pertamina sought to resist confirmation of the award in the U.S. The U.S. federal court concluded that under the New York Convention only a court with "primary jurisdiction" (a court of the country in which, or under the arbitration laws of which, the award was made) may annul an award, which in that case was the Swiss court. All other signatory states to the New York Convention have

(Continued on page 6)

Enforcing Arbitral Awards Against Sovereigns: Process and Pitfalls (cont'd.)

"secondary jurisdiction" and can only decide whether the award is to be enforced in that country. Accordingly, as a court of secondary jurisdiction, the Indonesian court's annulment was viewed as ineffective, and the U.S. court confirmed KBC's award.

Under certain circumstances an award annulled by a court in a primary jurisdiction may still be enforced in other New York Convention states. For example, a U.S. federal court confirmed the award rendered in Egypt against the Republic of Egypt and in favor of Chromalloy, a U.S. company, that had been annulled by the Egyptian Court of Appeal. The court held in that case that the Egyptian court's judgment violated U.S. policy favoring arbitration by ignoring the language in the parties' agreement prohibiting appeal of an arbitral award. Other decisions have since followed, suggesting that U.S. courts will not always confirm awards vacated in the country of origin, except in exceptional circumstances (as the D.C. Circuit reiterated in *TermoRio*) when the foreign annulment judgment is "repugnant to fundamental notions of what is decent and just in the State where enforcement is sought."

Much attention will now be focused on the enforcement proceedings recently initiated in the U.S. District Court for the Southern District of New York by Yukos Capital S.a.r.l, a former Luxembourg affiliate of Yukos. That affiliate is seeking to enforce four separate arbitration awards amounting to approximately US $420 million that were issued in Moscow in its favor and against Yuganskneftegaz, a predecessor of OJSC Oil Company Rosneft, a Russian state-controlled corporation that took over Yukos' production assets. All four awards were annulled by Russian courts. Earlier this year, however, the same awards were confirmed in the Netherlands where the Dutch court determined that the Russian judiciary was not independent and impartial when it came to Yukos and held that upholding a Russian court judgment vacating the awards in such circumstances would be contrary to Dutch public policy. That ruling is in line with *Chromalloy*. It will be interesting to see if the U.S. court takes a similar view.

As the New York Convention allows a court at the seat of arbitration to apply its domestic arbitral law when faced with a petition to vacate an award, most investors will resist agreeing to have arbitrations proceed in the project host country, or under its laws, where "home-town justice" may prevail.

Outside the U.S., the treatment of awards issued by commercial arbitration panels varies from country to country, depending on the country's own laws, whether it has acceded to the New York Convention or similar treaties, and on the interpretation of the matter at hand. Suffice it to say, issues may arise. Even sovereigns who are parties to the New York Convention could raise objections to recognition and enforcement beyond those enumerated in the convention, especially if the arbitration took place in their own country. As the New York Convention allows a court at the seat of arbitration to apply its domestic arbitral law when faced with a petition to vacate an award, most investors will resist agreeing to have arbitrations proceed in the project host country, or under its laws, where "home-town justice" may prevail.

Dealing with sovereign immunity defenses

The prevailing party in the arbitration is also likely to face challenges in any local forum in connection with claims of sovereign immunity relating to the recognition and execution of arbitral awards. Immunity from execution is distinct from immunity from suit and therefore waiver of immunity from suit (either by virtue of ratification of the relevant convention or express waiver of such immunity in the underlying contract giving rise to the arbitration) does not imply a waiver of sovereign immunity from execution. To ensure that a judgment entered on an arbitral award (or an ICSID award) can be executed, contracts with sovereign parties should include a separate clause providing for waiver of sovereign immunity from execution of any arbitral award (or a related judgment) rendered pursuant to an arbitration agreement among the parties.

Claims of immunity from recognition of an award

In the U.S., federal courts have the power to confirm arbitral awards, but to exercise that power they must establish jurisdiction over the matter and the defendant. In order to establish jurisdiction, it must be determined that the sovereign is not entitled to immunity from legal action in the matter in the U.S. and that proper service of process on the sovereign defendant was made pursuant to the *U.S. Foreign Sovereign Immunities Act* ("FSIA"). The FSIA provides the basis for obtaining jurisdiction over a sovereign in U.S. courts. It states that a foreign state and its agencies and instrumentalities are immune from the jurisdiction of U.S. courts unless one of the exceptions in the act applies. Typically, if a sovereign has consented to the arbitration and the arbitration occurred in the U.S., or if the arbitration award is governed by a treaty or other international agreement such as the New York or Panama Conventions calling for enforcement in the U.S., the federal courts will accept jurisdiction. For example, in a case involving a Canadian contractor who filed a petition in the U.S. to confirm arbitration awards against the Republic of Trinidad and Tobago, the U.S. federal court held that where a sovereign defendant was a party to the New York Convention, its agreement to arbitrate in a New York Convention signatory state implied a waiver of its immunity from jurisdiction in a proceeding to confirm the resulting awards in other signatory states. Even without such an explicit or implicit waiver of immunity by the sovereign, U.S. courts may exercise jurisdiction if the matter arbitrated was related to the sovereign's commercial activity carried on, or that causes a direct effect, in the U.S.

(Continued on page 7)

Enforcing Arbitral Awards Against Sovereigns: Process and Pitfalls (cont'd.)

Claims of immunity from execution of an award

Once the award has been confirmed (or if it is a final ICSID award), and if timely payment is not forthcoming, the next step is to seek attachment of sovereign assets to satisfy the outstanding liability. The difficulty with this step is not only that the sovereign may find ways to shield its assets, but also that most jurisdictions consider sovereign property immune from attachment, subject only to certain exceptions. The ICSID Convention, for instance, provides that its terms should not "be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution." This allows a recalcitrant sovereign to assert immunity defenses permissible under the laws of the country where the execution is sought. Exceptions to sovereign immunity vary depending on the jurisdiction. In many countries, execution is only possible against sovereign assets that are used for commercial purposes. Thus, investors need to determine the purpose of the property they are seeking to seize, although in certain jurisdictions the property's origin may also be an important consideration.

A wise investor should consider consulting with its prospective AAD underwriter *before* it settles on the terms of an arbitration provision in an investment agreement with a sovereign.

Attachment of a foreign sovereign's property in the U.S. is governed by the FSIA, which provides that when a foreign state is *not* protected by sovereign immunity, "the foreign state shall be liable in the same manner and to the same extent as a private individual under like circumstances." But under the FSIA the property of a foreign state in the U.S. is considered immune from execution unless the property is used for "commercial activity" and certain other exceptions, including waivers of immunity from execution and situations where "the judgment is based on an order confirming an arbitral award rendered against the foreign state," apply.

Where there is no express waiver of immunity from execution, immunity is normally accorded to central bank's accounts held for its own account. In addition, each country's courts will have their own notions of the circumstances under which so-called "mixed purpose" sovereign assets (i.e., those used for both commercial and public purposes) can be attached. In a case that arose out of an ICSID arbitration, the claimant attempted to attach bank accounts of the Embassy of Liberia in Washington DC. The federal court held that even though a sovereign's embassy accounts were used in part to fund its commercial activities, such accounts were nevertheless immune from attachment under the Vienna Convention on Diplomatic Relations and the FSIA. Generally, assets of diplomatic and consular missions are immune from execution.

In summary, if a sovereign chooses to resist enforcement of an arbitral award, it may have a number of ways to do so, subjecting the process to lengthy delays. In negotiating an arbitration provision with a sovereign, attention should be given not just to the prospect of winning the arbitration, but also to receiving timely payment.

Gauging how readily the award may be honored or enforced

Although not a full menu of things investors and underwriters need to look at in determining the prospects for enforcement of an award, here are some important considerations in drafting arbitration agreements and deciding on strategies for seeking recognition and execution of arbitral awards:

- Obtaining protection under international treaties such as ICSID Convention, New York Convention or similar treaties providing for recognition and enforcement of arbitral awards
- Drafting clear and unambiguous arbitration clauses that would include, among other things:
  - Clear choice of substantive and procedural laws to govern the arbitration
  - Selection of the seat of the arbitration in a neutral New York Convention country (when dealing with non-ICSID arbitration)
  - Express waivers of any and all sovereign immunity from suit and execution by the sovereign party and review of local law where enforcement may be sought to determine whether such waivers are enforceable
  - Parties' agreement to consider arbitral awards as final and binding and not subject to appeal
  - Provisions authorizing courts in any jurisdiction to enter judgment on the award
  - Parties' agreement for award of costs, attorneys' fees, interest and the currency for payment of the award to prevent post-award litigation of these matters
- Ensuring that the sovereign party has clear legal capacity and proper authorizations to enter into a commercial agreement
- Identifying countries where the sovereign has assets against which the award can be enforced
- Reviewing relevant treaties by which the sovereign party is legally bound as well as domestic laws in the host country that may impinge on enforcement of an award
- Understanding the behavior of the host country with respect to previous awards and as to international obligations generally

These matters also deserve the AAD underwriter's attention both as to the prospect of a claim arising and the likelihood of recovery if it is paid to the insured. A wise investor should consider consulting with its prospective AAD underwriter *before* it settles on the terms of an arbitration provision in an investment agreement with a sovereign. The underwriter may be a source of good advice, and may help to assure that the arbitration provision meshes well with the coverage that the investor hopes to arrange. ■

Letter to Our Readers

Dear Readers:

In 2003, I joined my long-time colleague, Robert Wray, in launching our law firm. Robert and I shared a vision of a highly focused practice that would offer excellent client service and foster a collegial atmosphere among our attorneys, advisers and staff. I believe we have succeeded in realizing that vision.

Robert's passing this year dealt a great personal blow to all of us at the firm. We miss his kindness, generosity and extraordinary legal acumen. But our firm continues to hold true to the objectives we established six years ago and we are gratified that our clients have shown confidence in our continued ability to deliver only the highest standard of service.

Our practice, which focuses on political risk insurance and aircraft and infrastructure finance, has not changed. Carrying on the strong interest and passion for international economic development that Robert instilled in us combined with the experience and unique capabilities of our team, we are pleased to add microfinance and international arbitration to our practice areas.

This edition of the Newsletter concentrates on the subject of international arbitration and the enforcement of arbitral awards, a matter of concern to both investors and political risk underwriters. We hope you find the Newsletter useful. Your suggestions and comments are welcome, as are contributions from leading figures in the political risk insurance and international arbitration communities.

Yours sincerely,

Geraldine R.S. Mataka
Managing Member

about this newsletter

Our intention is to provide a forum for the exchange of information and opinions relating to topics that will be of interest to political risk insurers, buyers, brokers, attorneys and others. We invite contributions and suggestions from professionals in the field.

We also encourage readers to submit information about notable transactions, personnel changes and other important developments in the political risk insurance sector.

The Newsletter is a periodic publication of robert wray PLLC and should not be construed as legal advice or relied upon as a substitute for legal advice.

If you would like to receive future editions of the PRI Newsletter electronically, or if you have friends or colleagues who would be interested in joining our distribution list, please e-mail us at *info@robertwrayplc.com*. This and previous editions of the newsletter are available at *www.robertwrayplc.com*

For submissions or further information regarding this Newsletter, please contact:

Geraldine R.S. Mataka
202.349.5016
gmataka@robertwrayplc.com

Felton (Mac) Johnston
202.349.5012
mjohnston@robertwrayplc.com

about robert wray PLLC

robert wray PLLC is a specialized law firm focused on analyzing complex issues and providing innovative solutions in the areas of political risk insurance, project finance, transportation infrastructure, privatization, aircraft finance, microfinance and international arbitration. The firm's political risk insurance practice offers comprehensive advice related to the mitigation of risks and selection and acquisition of political risk insurance associated with international investments. Felton (Mac) Johnston is the firm's expert adviser on the mitigation and insurance of political risks.

robert wray PLLC

1150 connecticut avenue, nw
suite 350
washington, dc 20036

Phone: 202.349.5000
Fax: 202.293.7877
E-mail: *info@robertwrayplc.com*

www.robertwrayplc.com